

**CITY OF SCOTTSDALE  
AUDIT COMMITTEE**

**MONDAY, AUGUST 25, 2008**

**CITY HALL, KIVA CONFERENCE ROOM  
3939 NORTH DRINKWATER BLVD  
SCOTTSDALE, AZ 85251**

**PRESENT:** W.J. "Jim" Lane, Chair  
Wayne Ecton, Councilman  
Ron McCullagh, Councilman

**STAFF:** Brent Stockwell, City Auditor's Office  
Lisa Gurtler, City Auditor's Office  
Joyce Gilbride, City Auditor's Office  
Kim Prendergast, City Auditor's Office  
Joanna Munar, City Auditor's Office  
Susan English, City Auditor's Office  
Neal Shearer, Assistant City Manager  
Richard Chess, Financial Services  
Scott McCarty, Financial Services  
Chief Willie McDonald, Fire Department  
Ginger Rogers, Fire Department  
Rich Upham, Fire Department  
Debra Baird, Community Services  
Tom Beat, Community Services  
Brian Dygert, WestWorld

**CALL TO ORDER/ROLL CALL**

Chairman Lane called the Audit Committee meeting to order at 2:59 p.m. Roll call was taken confirming the presence of all Committee Members.

**1. Approval of Minutes from the Regular Meeting on June 30, 2008**

Committee Member Ecton made a motion to approve the June 30, 2008, minutes. Committee Member McCullagh seconded the motion. The minutes were approved by a unanimous vote of three (3) to zero (0).

**2. Discussion of Audit Report No. 0801, Management of Assets Controlled by the Fire Department**

Chairman Lane noted that a review of the report showed minimal items of concern, and asked staff to report on any specific areas of note.

City Auditor Joanna Munar indicated the audit revealed that controls were in place and working as intended in regard to all equipment assigned to the firehouses and firefighters.

In the Resource Management Division the audit revealed the need for better inventory controls, as well as the need for a contingency plan and written procedures.

Chief Rich Upham said the Fire Department was aware of these weaknesses and was working to correct them before the audit began. The Department is researching software to track inventory, and the new written procedures are approximately 70 percent complete.

Chairman Lane asked what system is currently in place to track inventory. Chief Upham indicated the Department does track its entire inventory on Excel spreadsheets, which is not as user-friendly and organized as it could be. The Department knows how much equipment it has and where it is located, but the practices currently in place are not as efficient as they could be. The fire stations track and check their equipment daily, including expendable items.

Committee Member Ecton said the Fire Department is a new organization, and getting everything working properly is always a challenge. He indicated the City Manager should be monitoring the details in these instances. Committee Member McCullagh agreed that should be part of the start-up process.

Chairman Lane asked if there has been any determination whether there was any loss or misuse in this instance, and Ms. Munar indicated there was not.

Committee Member McCullagh asked if equipment assigned to firefighters or staff is tracked, and Chief Upham said each firefighter is responsible for a list of equipment that is assigned to them. They each sign taking responsibility for those items, and the Department tracks these items and exchanges inventory on a one-for-one basis, as needed. The field-level supervisors are responsible for making sure all employees have the equipment that is assigned to them and necessary to do their job.

Chairman Lane noted the audit included touring other Valley fire facilities, and asked if that was to observe the standard procedures of other fire departments. Ms. Munar said it was to observe how other cities inventory and control fire department assets, and indicated she found it to be very similar to what the Scottsdale Fire Department is doing.

Fire Chief Willie McDonald expressed appreciation for the manner in which the audit was conducted, and the assistance his department received from the Audit Department.

Committee Member Ecton made a motion to accept as presented Audit Report No. 0801, Management of Assets Controlled by the Fire Department. Committee Member McCullagh seconded the motion, which was approved by a unanimous vote of three (3) to zero (0).

### **3. Discussion of Audit Report No. 0804, Basin Management Funds**

Acting City Auditor Brent Stockwell said the Audit Department strives to get final reports to the Committee as early as possible in advance of the meeting for review, and indicated staff is available for any questions Committee Members may have.

Chairman Lane asked if the auditor who did the work should be signing off on these final reports, designating professional responsibility for an audit. Mr. Stockwell noted there is no requirement regarding this issue in Yellow Book standards; however, the auditor responsible is clearly identified in the transmittal letter. In addition, the auditor in charge electronically signs off on the work papers. A thorough quality review process is in place, which includes multiple levels of review before reports are published. Committee Member McCullagh asked if there was an industry standard regarding this practice. Chairman Lane said the industry standard would include the auditor signing the final report; however, that may not be a requirement with the City. Mr. Stockwell assured the Committee that all of the work coming out of the Audit Department is reviewed and supervised by the auditor-in-charge, as well as the supervisor and Acting City Auditor.

Committee Member Ecton stated in his opinion it appears there were many issues identified as needing improvement. He asked if these problems were systemic or due to the change in management. Auditor Kim Prendergast noted the issues ranged from 2003 to 2007, and were the result of both the practices of prior management as well as systemic.

Committee Member Ecton expressed concern that agreements were made verbally instead of going through the process. He asked what the position of Financial Services was on how the liability was accounted for and why this major issue had not been addressed before now. Scott McCarty, Financial Services, said when the decision was made to account for the funds coming from the Basin Management Program, staff decided to use a liability account in order to be more conservative. Once the decision is made how to spend those funds it becomes the City's money. Chairman Lane asked when that decision was made, and Mr. McCarty indicated this occurred when the original contracts were entered into. Noting issues of when expenditures were made, Chairman Lane disagreed that this is a more conservative approach. If the funds had been placed into revenue it would have been identified as such and there would have been greater accountability for the funds. Mr. McCarty clarified that by "conservative," he meant revenue was not being recorded without being sure the money could be spent. Chairman Lane said the intent of using those funds is to bring it back into properties or pay for other costs associated with it. Mr. McCarty said staff believes the funds should be placed in a deferred revenue account, and as soon as the decision is made that the money can be spent it will be transferred revenue and the expense recorded. Chairman Lane asked if there was a reason why the funds would not be placed in a revenue account. Mr. McCarty explained the definition of a revenue account means measurable and available, and while the funds are measureable, staff's position is it is not available until the Bureau of Reclamation approves its expenditure.

Committee Member Ecton expressed concern regarding verbal agreements that were made, and asked why and how that was allowed to happen. He noted this included a loan to the TPC, which was not paid on time and had no interest accrue. Contract Administrator Tom Beat explained the loan was for upgrading handicap-accessible bridges at the TPC, which the BOR approved as an appropriate use of the funds. As

revenues were collected the TPC was to repay the loan; however, construction of the Champions Course cut the revenue stream for a year. The TPC indicated they felt they had verbal approval by the City Manager to delay payment during that time. The loan has since been paid in full, with interest. From this point forward, all details will be put in writing. Chairman Lane asked who authorized this loan, and Mr. Beat indicated in this case the BOR approved the loan; the final authority at the City was the former City Manager. Going forward, a loan such as this would be taken before the City Council for approval.

Chairman Lane asked if Financial Services keeps track of billing for payments and interest. Mr. McCarty explained the normal process, and Ms. Prendergast said in this case the loan was not set up as a receivable account because it was a check requisition rather than a formal contract.

Chairman Lane asked whether these issues were corrected prior to the audit. Ms. Prendergast indicated the loan was repaid just prior to the start of the audit, and the interest was paid after the audit ended. The issue of interest payback was identified during the audit.

Committee Member McCullagh noted that most of the exceptions are the result of a lack of formal procedures, and asked if those procedures are now in place to avoid recurrence of the problems identified. Mr. McCarty emphasized that Financial Services staff feel comfortable with the procedures in place to execute components of contracts or agreements. Chairman Lane and Committee Member Ecton asked how the exceptions noted in this report occurred if procedures are in place to prevent it. Mr. McCarty stated staff did not review the contract annually as required, and Financial Services has enhanced the review of those contracts to ensure terms of the contract are enforced.

Chairman Lane asked for clarification regarding Item 4 of the report where it indicates documentation was insufficient to determine if BOR approval was obtained prior to the expenditure of Basin Management Funds. Ms. Prendergast said the audit examined seven expenditures among the three Basin Management Funds. On one of those expenditures the auditors were unable to locate sufficient documentation to determine whether there was BOR approval, although both Mr. Beat and the BOR representative recalled it being approved in writing. Mr. Stockwell explained the auditors did not have a concern about it not having approval; it was a question of recordkeeping. Ms. Prendergast pointed out the same set of circumstances apply to Item 5 of the report regarding City Council approval. Committee Member Ecton indicated since staff has been unable to find the documentation, it was likely a verbal approval.

Committee Member Ecton expressed concern regarding these funds not being included in the City's budget, and therefore the monies being spent are unauthorized. Ms. Prendergast explained one of the expenditures was transferred to a CIP account and was expended properly to purchase land. The other expenditures were paid out of a liability account and not transferred to an expenditure account. The creation of the new account where the funds will be held will ensure they will be expended with proper budget authority in the future. Mr. McCarty clarified that a significant amount of the money that has been expended from the Basin Funds went to City Council for approval as part of the formal CIP process.

Chairman Lane asked if there was potential legal exposure with the BOR. Mr. Stockwell indicated the audit did not identify a situation where there was not BOR approval; it was simply a documentation issue.

Mr. Stockwell noted that management has outlined procedures in the Action Plan that they are taking to ensure none of these issues exist in the future. Chairman Lane reiterated some of these procedures were already in place, and asked that staff be more diligent in the application of the procedures that already exist.

Committee Member McCullagh asked how much the City spent on the completion of the Champions Course. Mr. Beat stated the cost of that project was approximately \$11 million. Committee Member McCullagh asked if the City borrowed the money for that project. Mr. Beat indicated that was paid for with revenue bonds, and they will be paid from the rents generated from the Champions and TPC Stadium Courses. The annual revenue from those two courses is approximately \$1 million. Committee Member McCullagh asked if that revenue is used to amortize the bonds associated with the Champions Course and the 52 acres. Staff indicated they could provide that information to the Committee at a later date.

Councilman McCullagh noted the revenue from the golf courses is not reflected in the report. Mr. Beat clarified that is not a Basin Management Fund activity; it is a contractual obligation rent payment directly to the City.

The Committee accepted the Basin Management Funds Audit Report as presented.

#### **4. Staff update and discussion regarding status of current audits and special projects, including the Preserve Gateway fact-finding report**

Mr. Stockwell indicated Assistant City Auditor Joyce Gilbride has received her certified internal auditor designation. Kyla Anderson has been promoted to internal auditor. The resignation of the City Auditor's Office newest auditor resulted in external recruitment for a new position.

Management requested a 15-day extension for the WestWorld financial operations audit, which has been granted. The report will come before the Committee at the September meeting.

The Workers' Compensation audit is in the report writing stage, and staff anticipates presenting it to management as soon as the internal City Auditor's Office review is completed. Staff anticipates presenting that report to the Committee in October.

A series of cash handling audits have been completed and staff is working to finalize those and get the reports to the Committee by the October meeting.

The Development and Permit Fees Audit is underway and staff anticipates having that report to the Committee in November.

The City Fuel Usage audit will commence in September, and will be presented to the Committee in January.

In regard to the Preserve Gateway report, staff is finalizing the report. As the report was Council directed and not part of the audit plan, it is important to understand the Committee's expectation for the release of the information when it is complete. Mr. Stockwell asked for direction from the Committee in that regard. Chairman Lane suggested it be handled like a regular audit report. Mr. Stockwell indicated in that case the report would come before the Committee in September and then be released like any other audit report. He stated the challenge for staff has been that it is not an audit and does not follow the typical procedures.

Chairman Lane asked if there will be a secondary review to ensure the report is factual. Mr. Stockwell said staff has been conducting internal reviews with involved parties to make sure the information outlined in the report is consistent with their recollections of what occurred.

Committee Member Ecton said he does not see any problem bringing the report to the Audit Committee for review. The purpose is to understand the report so the Committee can make the full Council comfortable that it has been as accurately reported as possible.

Mr. Stockwell clarified the standard process would be to provide the report to the Committee and copy the City Council. The information would not be released until after the Committee has had the courtesy of a review.

In response to an inquiry by Committee Member Ecton, Mr. Stockwell explained staff has taken the Council's request for a fact-finding review very seriously and to make sure the information presented is factual and objective. He discussed the difficulty in objectively reporting on matters that are the subject of litigation, because information presented as fact may or may not be factual. The intent of looking at the court testimony was to understand the issues as they were presented.

Mr. Stockwell said the investigation was made more challenging by the fact that the matter was litigated. In the condemnation case all of the settlement discussions and work that occurred before the condemnation and during the trial was privileged information. The settlement discussions that the City and Toll Brothers were going through could not be discussed or presented to the jury, and because the information was privileged it was difficult to determine if staff was gaining a true picture of what happened prior to condemnation.

Committee Member Ecton stated he would hope this report could assist the City should it encounter a similar situation in the future. Mr. Stockwell said he believes that is consistent with staff's approach to this process.

In response to a query by Committee Member McCullagh, Mr. Stockwell said he would like to ensure that the team of auditors involved fully understood the issues and are in concurrence on the report. In addition, he would like to have a legal review of the report because the matter was in litigation.

Chairman Lane asked staff to inform the Committee Members when the report is complete.

**5. Discussion of Agenda Items for next Audit Committee meeting to be held at 3:00 p.m. on Monday, Sept 22, 2008**

Mr. Stockwell stated the next Audit Committee meeting is scheduled for Monday, September 22, 2008, at 3:00 p.m., and the WestWorld Financial Operations Audit Reports will be presented to the Committee at that time.

**Public Comment** - None

**Adjournment**

With no further business to discuss, the Audit Committee meeting adjourned at 4:26 p.m.